



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201025079**
Release Date: 6/25/10
Date: March 30, 2010
UIL Code: 501.03-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We made this determination for the following reason(s):

You failed to establish that you are organized and operated for purposes described in section 501(c)(3) of the Code. You did not file a substantially complete application, are not organized for an exempt purpose, do not operate exclusively for an exempt purpose and do not engage primarily in activities that accomplish an exempt purpose.

You have also failed to establish that you do not serve a private interest rather than a public interest within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations. You are operated to serve a private benefit rather than public interests. Accordingly, you are not an organization exempt from tax under section 501(c)(3) of the Code.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate

court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: January 21, 2009

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

President =
B =
N =
Website =
State =
New State =
Date =
Date2 =

Dear

We have considered your application for recognition of exemption from Federal income tax under section 501(a) of the Internal Revenue Code (Code). Based on the information provided, we have concluded that you do not qualify for exemption under section 501(c)(3) of the Code. The basis for our conclusion is set forth below.

Facts:

You initially incorporated on Date in State. Soon after, you filed a Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Code. On Date2, you informed us that you had never commenced business in State, had moved to New State, and had reincorporated in New State, and submitted a revised application. Later, you advised us that you had dissolved the corporation in State and filed a third, revised application. None of your applications included articles of incorporation with a state stamp or other evidence showing that you filed them with and obtained approval from the appropriate state authority on a specific date, as requested by the form. You also did not provide an acceptable substitute for certification such as a copy of your articles of incorporation accompanied by a declaration, signed by an officer authorized to sign for you, that the copy is a complete and correct copy of your articles of incorporation. Also, the third, revised application that you filed reported zero amounts on the statement of receipts and expenditures and the balance sheet.

Your articles of incorporation state that you are organized exclusively for charitable and educational purposes, including:

- The making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code of 1954,
- To underwrite delivery of charitable services to the poor, disabled or disadvantaged in the operation of a free Internet human needs and resources matching service operated by N when economic, educational, and/or social need can be demonstrated,
- Provide free shipping of items from donors to the poor, disabled or disadvantaged recipients, and
- Carry on lawful business activities allowed by nonprofit corporations in State, subject to the limitations of section 501(c)(3) of the Internal Revenue Code.

Since you stated that you primarily operate your website to deliver charitable services to the poor, disabled or disadvantaged, we asked what steps you take and what criteria you use to establish whether a recipient meets those requirements. You replied that the donor makes that evaluation, that you do not monitor the activities that take place on your website and users must make their own arrangements for completing their transactions. You added that you also do not plan to make grants, loans or distributions to other organizations.

You will promote your website by conducting the following activities:

- Organizing a speakers bureau for making presentations to civic groups, social service organizations, churches, schools, and government agencies,
- Recruiting volunteers around the U.S. and on your website,
- Issuing press releases,
- Garnering feature coverage in all free media such as print, radio, and TV,
- Buying online advertising,
- Writing stories and blogs,
- Participating in forums, social networks, and other networks aligned with your purpose,
- Contacting numerous community and individual opinion leaders,
- Producing audiovisual products to promote your service on internet video sites, and
- Reaching out to non-profit and corporate underwriters to piggyback on existing publicity or to underwrite your own initiatives.

You compare your website favorably with other well-known online commercial marketplaces. Like them, your website provides registered members with an online searchable database of available goods and services. Although your website is open to the public, you require users to register before they participate. After registration, a member may post an ad to offer or search the database to find goods or services. Your website assists the exchange of offer and acceptance emails between members and you created a medium of currency unique to your website to measure the value of each transaction. Finally, your system tracks and posts the value of pending and completed transactions for each member so that other members can assess the risk of entering into a transaction with that member.

You will generate revenue by soliciting public support such as gifts of real and intellectual property, but will not charge fees for the transactions that take place on your website. Your fundraising efforts will include:

- Providing an online payment service with a “click to donate” option on your website so that participants may make cash contributions,
- Conducting email fundraising and newsletter campaigns,
- Sustaining the ability to accept any type of contribution,
- Soliciting contributions by mail, and
- Accepting funds raised by other non-profit organizations.

Your President owns the copyright for your website. Your President and B, your vice president, are two of your three compensated officers who are also board members. Your President and B own the rights to the database, artwork, films, text and all other technical and artistic property used on the website. Your President and B are also the two partners of N, a partnership that operates the website for you. You contracted to lease the website and related intellectual property from N for one dollar a year.

Law:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 513(a) of the Code states, in part, that the term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the needs of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 1.501(a)-1(a)(2) of the Income Tax Regulations (regulations) states that an organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish its exemption, it is necessary that every such organization claiming exemption file an application form with the Internal Revenue Service.

Section 1.501(a)-1(a)(3) of the regulations states that an organization claiming exemption under section 501(a) and described in any paragraph of section 501(c) (other than section 501(c)(1)) shall file the form of application prescribed by the Commissioner and shall include thereon such information as required by such form and the instructions issued thereto.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b) of the regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and specifically that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(1)(iii), Example (3) of the proposed regulations describes O, an educational organization the purpose of which is to train individuals in a program developed by P, O's president. All of the rights to the program are owned by Company K, a for-profit corporation owned by P. Prior to the existence of O, the teaching of the program was conducted by Company K. O licenses, from Company K, the right to use a reference to the program in O's name and the right to teach the program, in exchange for specified royalty payments. Under the license agreement, Company K provides O with the services of trainers and with course materials on the program. O may develop and copyright new course materials on the program but all such materials must be assigned to Company K without consideration if the license agreement is terminated. Company K sets the tuition for the seminars and lectures on the program conducted by O. O has agreed not to become involved in any activity resembling the program or its implementation for 2 years after the termination of O's license agreement.

O's sole activity is conducting seminars and lectures on the program. This arrangement causes O to be operated for the benefit of P and Company K in violation of the restriction on private benefit in section 1.501(c)(3)-1(d)(1)(ii), regardless of whether the royalty payments from O to Company K for the right to teach the program are reasonable. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

Section 1.501(c)(3)-1(e)(1) of the regulations states that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Rev. Rul. 76-442, 1976-2 C.B. 148, denied exempt status to an organization that provided free legal services for personal and estate tax planning for individuals who wished to make gifts to charity as part of their tax planning. The Service found that the organization was not operated

exclusively for charitable purposes because its primary purpose was to provide commercial tax services to individuals who were not a charitable class. The benefits to the public were tenuous.

Rev. Proc. 2009-9, 2009-2 I.R.B., section 3.03 states that an organization seeking recognition of exemption under section 501(c)(3) must submit a completed Form 1023.

Rev. Proc. 2009-9, 2009-2 I.R.B., section 3.08(3) states that a substantially completed application, including a letter application, is one that includes a statement of receipts and expenditures and a balance sheet for the current year and the three preceding years (or the years the organization was in existence, if less than four years). If the organization has not yet commenced operations, or has not completed one accounting period, a substantially completed application generally includes a proposed budget for two full accounting periods and a current statement of assets and liabilities.

Rev. Proc. 2009-9, 2009-2 I.R.B., section 3.08(6) states that a substantially completed application, including a letter application, is one that, if the organizing or enabling document is in the form of articles of incorporation, includes evidence that it was filed with and approved by an appropriate state official (e.g., stamped "Filed" and dated by the Secretary of State). Alternatively, a copy of the articles of incorporation may be submitted if accompanied by a written declaration signed by an authorized individual that the copy is a complete and accurate copy of the original copy that was filed with and approved by the state. If a copy is submitted, the written declaration must include the date the articles were filed with the state.

In Better Business Bureau of Washington D.C., Inc. v. U.S., 326 U.S. 279, 66 S. Ct. 112, 90 L. Ed. 67, 1945 C.B. 375 (1945), the Supreme Court held that the presence of even a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by for-profit commercial businesses. Its primary purpose was not charitable, educational, nor scientific, but commercial. The court found that the corporation failed to demonstrate that its services were not in competition with commercial businesses.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) aff'g 70 T.C. 352 (1978), the court held that a vegetarian restaurant and health foods store that adhered to the principles of the Seventh Day Adventist Church was not operated exclusively for exempt religious purposes, but rather for a substantial commercial purpose. The court examined the method of operations to infer the purposes. Although the organization catered to the dietary restrictions of the Church, its primary activities were managing a restaurant and health food store, which operated in competition with commercial entities, charging competitive prices set by formulas common in the retail food business, and using commercial promotional methods.

In Church by Mail v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), aff'g TCM 1984-349 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated:

The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church.

In Arlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the District Court found that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions on its facilities. The organization paid significant advertising and promotional expenses and derived substantial income from events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as non-commercial entities, which strongly evidenced a commercial nature and purpose.

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

Thus, the court looked at the business methods of the organization as a method of inferring whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit.

Analysis:

Based on the information you provided in your application and supporting documentation, we conclude that you are not an exempt organization described in section 501(c)(3) of the Code. First, in order to be exempt as an organization described in section 501(c)(3), an applicant must file a substantially completed application that includes the information required by the form and instructions. You did not provide the certified organizing documents, a substitute certification, or the financial information required by section 501(a)-1(a)(3) of the regulations, Form 1023 Instructions, and Rev. Proc. 2009-9, 2009-2 I.R.B. Second, an exempt organization must be both organized and operated exclusively for exempt purposes. If an organization fails to meet either the organizational test or the operational test described in section 1.501(c)(3)-1(a)(1) of the regulations, it is not exempt. The information you provided shows that you are not organized or operated for an exempt purpose described in section 501(c)(3) of the Code.

To establish exemption from tax under section 501(c)(3), an organization must first pass the organizational test set out in section 1.501(c)(3)-1(b) of the regulations. Under this test, an applicant's articles of organization must limit the organization's purposes to one or more exempt purposes specified in section 501(c)(3). In addition, the articles may not authorize the organization to engage in substantial activities that are not in furtherance of an exempt purpose. Your articles of incorporation state, in part, that you are organized to "underwrite delivery of charitable services to the poor, disabled or disadvantaged in the operation of a free Internet human needs and resources matching service". Since operating an online bartering service is not an exempt purpose described in section 501(c)(3), your articles of incorporation do not limit

your purposes to one or more exempt purposes described in section 501(c)(3) and authorize you to engage in substantial activities that do not further an exempt purpose. The information you provided does not meet the requirements of the organizational test in section 1.501(c)(3)-1(b).

Second, the information provided by the organization must demonstrate conclusively that it meets the operational test described in section 1.501(c)(3)-1(c) of the regulations. The operational test first requires an organization to prove that it operates exclusively for one or more exempt purposes within the meaning of section 501(c)(3) of the Code. An organization will be regarded as "operated exclusively" only if it engages primarily in activities which accomplish one or more of the exempt purposes described in section 501(c)(3). The presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes. See Better Business Bureau of Washington, D.C. v. U.S., *supra*. Your purpose and principal activity is the operation of an internet matching service for the general public. An organization that operates primarily to conduct a trade or business that is unrelated to an exempt purpose described in section 501(c)(3) will not pass the operational test.

However, organizations that operate a trade or business as a substantial part of their activities may meet the requirements of section 501(c)(3) of the Code if the activity is related to and furthers an exempt purpose. Section 1.501(c)(3)-1(e)(1) of the regulations. Several courts have considered nonprofit organizations that conduct businesses to determine whether the business was conducted for an exempt purpose or for a commercial, non-exempt purpose. See B.S.W. Group, Inc. v. Commissioner, Living Faith, Inc. v. Commissioner, and Arlie Found. v. IRS, *supra*. These courts considered such factors as the particular manner and commercial hue of the activities an organization conducts and the existence and amount of annual or accumulated profits to determine the existence of a nonexempt commercial purpose. The exchange of goods and services is the essence of commercial activity.

You have failed to establish that your activities accomplish any of the charitable purposes described in section 501(c)(3) of the Code, which includes the relief of the poor and distressed or of the underprivileged and the advancement of education in the definition of the term "charitable". Like other online commercial websites, you do not monitor users' activities and they must make their own arrangements with regard to their transactions. Further, you have failed to provide confirmation that you provide relief to any charitable class, since your members, not you, determine whether a recipient is poor, distressed or underprivileged. You are like the organization described in Rev. Rul. 76-442, *supra*, because you are not operated exclusively for a charitable purpose and your primary purpose is to operate an online commercial bartering marketplace for individuals who are not a charitable class.

Competition is strong evidence of a commercial nature and purpose. You compared your bartering website favorably to several other commercial retail websites. To compete successfully, you maintain a website open to the public; plan significant advertising, marketing and promotion activities; place a value on the transactions; and offer an online payment service option. The information you provided shows that you primarily operate a bartering website for a commercial, non-exempt purpose.

The operational test also assigns the burden of proof to an applicant to show that it serves a public rather than a private interest and specifically that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly by such private interests. See section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Control is an important factor in determining whether an organization operates for the benefit of private interests. Your President, and B, your vice president, are the partners of N, who operates your primary activity, the website. Your President and B also own all rights to the database and the artwork, films, text and other technical and artistic property that you publish and promote on your website. Like the organization described in *Church by Mail v. Commissioner, supra.*, you are operating to create a market for N's services and your President and B's intellectual property. Like the organization described in section 1.501(c)(3)-1(d)(1)(iii), Example (3) of the regulations, your operations provide a benefit for your creator, a for-profit entity owned by your creator, and your registered members, in more than an incidental way. You have failed this part of the operational test because you are organized and operated for the benefit of your President, B, and N in violation of the restriction on private benefit, regardless of whether lease payments for the right to use the website are reasonable.

Conclusion:

Based on the information you provided, we conclude that you are not entitled to recognition of exempt status under section 501(c)(3) of the Internal Revenue Code because you did not file a substantially completed application, are not organized for an exempt purpose, do not operate exclusively for an exempt purpose and do not engage primarily in activities that accomplish an exempt purpose. Your principal activity is the operation of a commercial bartering website that does not achieve charitable or educational purposes. Even if you were able to establish that you were formed and operated for charitable or educational purposes, you would not qualify for exemption because you are operated for a substantial non-exempt purpose. You are operated for the purpose of serving a private benefit rather than public interests. Accordingly, you are not an organization exempt from tax under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS*.

and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE SE:T:EO:RA:T:2

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements